

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Romero Analyst: Darrine Distefano Bill Number: SB 389

Related Bills: See Legislative History Telephone: 845-6458 Amended Date: April 1, 2003

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Taxpayers Provide FTB With Specified Information Regarding Various Corp Tax Credits/Failure To File Information Penalty/FTB Publish & Provide Information To Legislature & Public Regarding Corps Claiming Credits/Include Posting on Website

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _____.

☒ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended _____.

FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO _____.

REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED/AMENDED _____ STILL APPLIES.

☒ OTHER - See comments below.

SUMMARY

This bill would require a corporate taxpayer to provide the Franchise Tax Board (FTB) with a list of specific information when certain credits are claimed on their corporate tax returns. This information would be provided to the Legislature and the public, and also would be published on FTB's website.

SUMMARY OF AMENDMENTS

The April 1, 2003, amendments deleted the Legislative intent language concerning the effectiveness of corporation tax credits and added the language discussed in this analysis.

The department's analysis of the bill as introduced February 20, 2003, no longer applies.

PURPOSE OF THE BILL

According to the author's staff, the purpose of this bill is to generate information about the effectiveness of tax credits provided to corporations and the economic impact of those credits on the state.

EFFECTIVE/OPERATIVE DATE

This bill would be effective and operative January 1, 2004.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Gerald H. Goldberg

5/28/03

POSITION

Pending.

SUMMARY OF SUGGESTED AMENDMENTS

Amendments have been provided to correct a technical consideration.

ANALYSIS

STATE LAW

Existing state law prohibits the disclosure of any taxpayer information, except as specifically authorized by statute. Taxpayer information includes the amount of income earned, or any particulars on the return, including the business affairs of a corporation. Under the corporation tax law, a taxpayer is defined as any association, corporation, business, trust, or organization of any kind subject to corporation franchise tax.

Existing state law, in limited instances, permits the department to release tax return information to certain state agencies, such as legislative committees, the Attorney General, the California Parent Locator Service, the directors of Social Services and Health Services, and California tax officials, such as the Board of Equalization, the Employment Development Department, the State Controller, and the Department of Motor Vehicles. State agencies must have a specific reason for requesting the information, i.e., tax investigation, verifying eligibility for public assistance, locating absent parents to collect child support, or locating abducted children. For some agencies, only limited information may be released, such as the taxpayer's social security number and address.

Existing state law permits the department to release tax return information according to tax return sharing agreements with the IRS, the Multistate Tax Commission (MTC), and taxing authorities of other states. The exchange must relate to the enforcement of tax laws, and the information must not be made public. Shared information includes sales tax, income tax, and corporation tax return data. The tax return information relating to multi-state and multi-national tax audits is shared with the MTC.

The Revenue & Taxation Code (R&TC) provides that certain extraneous matters relative to a corporation may be disclosed only in response to a request regarding a named entity and only if there is no reason to believe that the information will be used for commercial list purposes.

The R&TC considers extraneous matters to be the exact corporate title, corporate number, the date of the commencement of business in this state, taxable year adopted, filing date of return, name, date, and title of individuals signing affidavit to the return, due date of the taxes, taxes unpaid, entity's address, and private address of officers and directors.

Under the R&TC, existing state law provides special tax incentives for taxpayers conducting business activities within economic development areas. These incentives include a sales or use tax credit, hiring credit, business expense deduction, and special net operating loss treatment. Two additional incentives include net interest deduction for businesses that make loans to businesses within an enterprise zone and a tax credit for employees working in an enterprise zone.

Existing state law also provides a research credit, manufacturers' investment credit, prison inmate credit, and a joint strike fighter wage credit to taxpayers that hire specific individuals to work, conduct research, or use property for business activities within California.

THIS BILL

This bill would require corporate taxpayers that claim specified credits to provide the department with the following information:

- The name of the taxpayer claiming the specified credit, and either the Standard Industrial Classification (SIC) Code, or the North American Industry Classification System (NAICS) that corresponds to the SIC Code, of the taxpayer,
- The amount of the specified credits claimed,
- The number of full-time equivalent employees and the median weekly wages or salary paid, and
- The percentage of rank and file employees for which the taxpayer pays at least 80% of health or medical insurance premiums.

This information would be required to be filed with the taxpayer's original return for each taxable year.

This bill would apply to corporate taxpayers that claim the following credits:

1. Research (R&D) expenses credit.
2. Enterprise zone (EZ) hiring credit and sales or use tax credit.
3. Manufacturing enhancement area (MEA) hiring credit.
4. Prison inmate labor credit.
5. Targeted tax area (TTA) hiring credit and sales or use tax credit.
6. Joint strike fighter (JSF) program credit.
7. Local agency military base revitalization area (LAMBRA) hiring credit and sales or use tax credit.
8. Manufacturer's investment credit (MIC).

FTB would be required to develop a form and method for providing the requested information that is simple and efficient for the taxpayer. This bill would require the taxpayer to retain any documents and information necessary to substantiate the information provided on the separate form.

For any taxpayer claiming the R&D credit, inmate labor wages credit, JSF wages credit, or the MIC, the requested information is limited to the taxpayer's trade or business within the state. For any taxpayer claiming any of the tax credits in an EZ, MEA, TTA, or LAMBRA, the requested information is limited to activities in each of those areas and for the state as a whole.

This bill would impose a penalty of \$1,000 for each taxable year that the taxpayer fails to file the required information. FTB would mail a notice to the taxpayer of the failure to file with the imposed penalty. If the taxpayer fails to file the information within 90 days from the mailing date of the notice, an additional penalty of \$1,000 would be imposed for each 30-day period that the failure to file continues. The penalty would not exceed \$24,000 for any taxable year.

This bill would deny the credits allowed to the taxpayer until the required information is filed with FTB.

This bill would not impose a penalty or deny any of the credits if the failure to file the required information is due to reasonable cause and not willful neglect.

This bill would require FTB to publish the required information on an annual basis. This information would be provided to the Legislature and the public in a form determined by FTB. This information would also be published on FTB's website.

This bill would require the Legislative Analyst's Office (LAO) to report to the Legislature on the statewide impact that the credits specified in this bill have on employment and wages in the state.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

Disclosure & Information Forms

Existing law prohibits any department employee from releasing confidential state tax information. An unauthorized disclosure is punishable as a misdemeanor. Much of the information that would be published under this bill contains confidential tax information that would constitute an unauthorized disclosure. It is unclear how the department would protect the identity of individual taxpayers within a corporation without violating the existing disclosure law.

This bill would require a corporate taxpayer that claims any of the specified credits to provide information about the taxpayer's activities. If the taxpayer were a large corporation with numerous subsidiaries, the department would create one schedule for the taxpayer to list the specified information. If the author's intent were to require more detail on each subsidiary, the department would require further clarification.

It is not clear if FTB would be expected to audit these information forms for correct information. Since the department's role is to administer the Personal Income Tax Law (PITL), the Corporate Tax Law (CTL), and the Administration of Franchise and Income Tax Laws (AFITL) under the R&TC, FTB would not be aware if employee information provided by the taxpayer is correct. FTB would also have no use for any of the information provided, except to publish and to post the information on FTB's website as required by the bill. If the incorrect information were published, the bill's intent may not be met because the Legislature and the public would not get a clear picture of the corporations' business activities. Also, releasing and publishing incorrect information would reflect poorly upon the department and the corporation.

Imposition of Penalty and Suspension of Credits

This bill would require a penalty to be imposed and the credits to be denied for failure to file the information with the original return. As a practical matter, adjustments to items shown on a tax return must either be made automatically during the processing of the return or later during an audit of the return. Specifically, denial of tax credits and imposition of penalties during return processing requires statutory language exempting these adjustments from normal deficiency procedures. Otherwise, the adjustments do not become effective until after an audit, protest, and appeal process. Therefore, the author may wish to add specific language to require the listed credits to be disallowed during return processing and to impose the penalties automatically, ("due and payable upon notice and demand,") similar to late payments, late filing penalties, and to mathematical errors. The penalty should also be added to the taxpayer's tax in order to reduce a claimed refund or carryforward of any credits.

This bill would not impose a penalty or deny the credits if failure to file is due to reasonable cause. Technically, the taxpayer would have to show reasonable cause some time after the penalty has been imposed and the credits have been disallowed. Therefore, the author may wish to add language that clarifies that the penalty (which was already imposed during return processing) can be "abated" and the credits can be allowed even if the required information is not supplied after reasonable cause is shown.

The term "reasonable cause" is also very broad. The author may wish to further clarify the reasonable cause provision to specifically provide under what circumstances a taxpayer that fails to provide the required information should be allowed the credits and relieved from penalties. This clarification would avoid confusion for the taxpayer and the department. The more likely a taxpayer can establish (to the satisfaction of the FTB, the State Board of Equalization, or the courts) that the taxpayer's failure to provide the required information was due to reasonable cause and not willful neglect, the less likely taxpayers will comply with the reporting requirements of this bill.

It is unclear whether the penalties are intended to apply where a taxpayer files an amended return and decides not to claim the credits upon notice and the imposition of the first penalty. Similarly, if the taxpayer has filed an amended return because it is determined they do not qualify for the credits, it is unclear if the penalty should be abated.

This bill does not specifically require taxpayers to report the amount of any carryover credits claimed in the current year, but generated in prior years. Also, this bill does not require the taxpayer to report information with respect to credits generated in the current year but carried forward to future years. Therefore, it is unclear if this bill would impose the penalties and deny the credits for failure to provide this information. If a taxpayer does not claim any credits, but instead claims the carryover of credits claimed in earlier years, it is unclear whether this bill would "suspend" the allowance of the carryover as it would the credits.

Sunset dates generally are provided with credits to allow periodic review by the Legislature. The author may wish to add a sunset date to review taxpayer compliance with the provisions of this bill and to ensure that the intent of the bill is being met.

The department may have to pay interest on delayed refunds due to the additional processing time for the data capture and validation of the specified information.

TECHNICAL CONSIDERATIONS

The requirement for the LAO to evaluate the impact of the specified credits does not appear linked to the department's reporting requirement. This requirement should be placed in a separate code section more appropriate for the LAO, rather than within the income tax law administered by the department.

This bill requires corporations to provide the specified information by the due date of the return. However, it does not include an exempt organization return. Since these types of entities can also claim the specified credits, the author may wish to include under subdivision (a) of Section 19141.7 of the R&TC reference to Section 23771 that provides the due date for exempt organizations to file a return to report unrelated business income and pay the tax on that income.

It is not clear why subdivision (f) refers to Part 10, the PITL, when this bill only applies to corporate taxpayers and tax credits under Part 11 of the CTL. Also, if this reference is correct, on page 4, line 17, Section "170010," should be amended to read "17001."

Amendments 1 & 2 would correct the name of the credits to local "agency" military base recovery area.

LEGISLATIVE HISTORY

AB 1220 (Romero 1999/2000) was similar to this bill. The Governor vetoed this bill because of the administrative costs the department would have incurred.

OTHER STATES' INFORMATION

The states surveyed were *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Florida, Michigan, and Minnesota do not require a corporation to file a separate return or schedule with specified information.

Illinois, Massachusetts, and New York require corporations to file an annual report with specific information such as name of corporation, gross receipts, sales and profit, tax, and credits taken. *Massachusetts* requires a corporation to list the amount of credit taken. None of these states assess a penalty for failure to file this information. None of these states require the corporations to list the SIC code or NAICS, number of full time employees and salary paid, or the number of employees that the taxpayer pays health insurance for. This information is available to the public. This annual report does not have to be filed with a corporation's tax return.

FISCAL IMPACT

First year implementation costs are estimated to be in the range of \$1.8 to \$2.0 million and would require the department to incur 28 additional personnel years (PYs). The estimated departmental costs and PYs are associated with printing and processing of the additional form, program changes to the Business Entity Tax System for denying the specified credits and assessing the penalty, creating data fields for additional information required to be captured as specified in this bill, and publishing the required information on FTB's Internet Web site.

Ongoing costs are estimated to be in the range of \$1.3 to \$1.5 million with 26 PYs for processing the additional form and system maintenance.

ECONOMIC IMPACT

This bill would not impact the state's income tax revenues.

ARGUMENTS/POLICY CONCERNS

California has a self-assessed tax system that relies on the responsiveness of the individual and corporate taxpayer to report the proper tax. If tax information is used or disclosed for reasons beyond reporting for tax purposes, there could be an impact on information reported on tax returns.

This bill would not apply to taxpayers who claim the specified credits under the PITL, namely S corporation shareholders, partners, and sole proprietors.

This bill would not apply to the joint strike fighter property credit.

The specified credits were enacted to influence certain taxpayer behavior and to stimulate the economy for disadvantaged areas. The additional requirements proposed by this bill may place a burden on taxpayers to collect the required information.

LEGISLATIVE STAFF CONTACT

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SB 389
As Amended April 1, 2003

AMENDMENT 1

On page 2, line 36, strikeout "area" and insert:

"agency"

AMENDMENT 2

On page 3, line 29 and line 31, strikeout "area" and insert:

"agency"